

Regulation 1540. Advertising Agencies, Commercial Artists and Designers.

(a) Advertising Agencies ~~as Agent of Client or as Non Agent.~~

(1) General. Advertising agencies provide clients with both services and tangible personal property. Services include, without limit, consultation, consumer research, and media placement. Tangible personal property includes, without limit, video and audio productions, print advertisements, brochures, finished artwork, and other printed matter. When an advertising agency provides services unrelated to the transfer of tangible personal property or when the tangible personal property transferred is incidental to the services, the charges for those services are nontaxable. An agent is one who represents another, called the principal, in dealings with third persons. (Civil Code, Section 2295.) Advertising agencies may act as agents on behalf of their clients in dealing with third persons or they may act on their own behalf. To the extent advertising agencies act as agents of their clients in acquiring tangible personal property they are neither purchasers of the property with respect to the supplier nor sellers of the property with respect to their principals.

Application of tax to the sale of tangible personal property and any services related to the sale is dependent on the type of property being sold and the relationship of the advertising agency to the client. To the extent advertising agencies act on their own behalf in acquiring tangible personal property they are purchasers of the property with respect to the supplier. Generally, they are sellers of any of the property so acquired which they deliver to, or cause to be delivered to, their clients or to third parties for the benefit of their client. They are also sellers of any of the property which they retain but title to which they transfer to their client.

(2) Specific Situations ~~Determination of Status.~~

(A) Electronic or Digital Artwork. Items Acquired from Outside Sources. Electronic or digital art is the process of using computer software and hardware to compile or compose finished art. Elements of the process include: creation of original artwork or photographs, scanning of artwork or photographs, composition and design of text, insertion and manipulation of scanned and original digital artwork, photographs, or text. All acquisitions by advertising agencies of tangible personal property such as collateral materials (catalogs, brochures, pamphlets, and the like), artwork (photographs, drawings, paintings, designs, lettering, and the like), and production items (engravings, duplicate plates, mechanicals, assemblies, sound recordings, and the like), are regarded as purchases by the agencies on their own behalf for resale or use unless the agency clearly establishes with respect to any acquisition that it is acting as agent for its client.

A transfer of electronic or digital art from an advertising agency, commercial artist or designer to a client or to a third party on behalf of a client that includes text or images or a combination of both, is not taxable if, (1) the file containing the electronic or digital art is transferred through remote telecommunications, such as a modem, or (2) the file is downloaded on the client's computer by the advertising agency, commercial artist or designer and the client does not obtain title to or possession of any tangible personal property, such as a diskette or compact disk. The advertising agency, commercial artist, or designer should document the downloading of electronic artwork in the manner set forth in subdivision (d)(2). Transfer of a file qualifying as electronic or digital pre-press instruction as defined by the provisions of Regulation 1541, Printing and Related Arts, is nontaxable. To establish that a particular

~~acquisition was made as agent for its client (i) the agency must clearly disclose to the supplier the name of the client for whom the agency is acting as agent, (ii) the agency must obtain, prior to the acquisition, and retain written evidence of agent status with the client, and (iii) the price billed to the client, exclusive of any agency fee, must be the same as the amount paid to the supplier. The agency may make no use of the property for its own account, such as charging the item to the account of more than one client. An advertising agency purchasing tangible personal property as an agent on behalf of its client may not issue a resale certificate to the supplier. It will be presumed that an advertising agency who issues a resale certificate to its supplier is purchasing the tangible personal property on its own behalf for resale and is not acting as an agent for its client.~~

A transfer of title to or possession of a file on electronic media, such as a diskette or compact disc, is subject to tax as stated in subdivision (d)(2). The reimbursement for the property should be separately invoiced, or shown separately on an invoice, to the client.

(B) Agency Acting as an Agent for Its Client. Items Prepared by Agency. An agent is one who represents another, called the principal, in dealings with third persons. (Civil Code, Section 2295.) To the extent an advertising agency acts as an agent of its client in acquiring tangible personal property, it is neither a purchaser of the property with respect to the supplier nor a seller of the property with respect to its principal. Because of the unique relationship between advertising agencies and clients, it is rebuttably presumed that an advertising agency qualifies as an agent when acquiring tangible personal property on behalf of its client. However, an agency is not an agent of its client with respect to tangible personal property fabricated or produced in-house by the agency's own employees and sold to its client. Advertising agencies are sellers of all items of tangible personal property produced or fabricated by their own employees. Advertising agencies are not agents of their clients with respect to the acquisition of materials incorporated into items of tangible personal property prepared by their employees.

As an agent for its client, sales or use tax is due on the purchase price from the suppliers to the advertising agency. Tax does not apply to the charge made by an advertising agency to its client for reimbursement, including tax reimbursement, charged by a supplier or to charges or fees for an agency's services directly related to such acquisitions of tangible personal property.

An advertising agency may not issue a resale certificate when making purchases as an agent. It will be presumed that an advertising agency who issues a resale certificate to a supplier is purchasing tangible personal property on its own behalf for resale and is not acting as an agent for its client. However, the advertising agency may provide evidence to prove that the presentation of the resale certificate was erroneous and that the advertising agency was acting as an agent of its client. If the resale certificate was issued in error, the advertising agency is liable for use tax on the cost of tangible personal property purchased under the certificate unless, 1. The agency has already paid tax to the supplier or to the Board, or 2. The client has self-reported the tax.

(3) Advertising Agencies Acting as Retailers.

(A) Election of Non-Agent Status. An advertising agency may elect non-agent status with respect to sales to its client. This election must be supported by a specific written statement in its contract or

agreement with the client. Alternatively, a statement may be included on an agency's invoice to its client. Statements should include the following or similar language: "(Agency name) does not qualify as an agent of (client name) for purposes of this transaction."

An agency that elects non-agent status is a retailer with respect to tangible personal property sold to its clients. The agency may issue a resale certificate to its suppliers for tangible personal property that it is planning to resell to clients or to incorporate into property that will be sold to clients.

The taxable selling price is the separately stated charge for the tangible personal property. If there is no separately stated charge, the taxable selling price may be calculated as shown in subdivision (b).

(B) Items Produced or Fabricated by an Agency In-House. Advertising agencies are retailers of tangible personal property produced or fabricated by their own employees. Advertising agencies are not agents of their clients with respect to the acquisition of materials incorporated into items of tangible personal property prepared by their employees. However, in the case of intermediate production or printing aids used by the agency's employees to fabricate tangible personal property, it will be presumed that an advertising agency passes title to the aids to the client prior to use by the agency and the measure of tax will be computed in the same manner as provided in Regulation 1541 for special printing aids. Intermediate production or printing aids include, but are not limited to, artwork, illustrations, photography, photo engravings, and other similar materials.

Except for artwork, tax is due on the taxable selling price of tangible personal property fabricated or produced by the agency's employees. Artwork shall be taxed in the manner set forth in subdivision (b)(1) or (d)(1). An advertising agency should issue a resale certificate for items that become an ingredient or component part of such tangible personal property and for intermediate production or printing aids. The term "ingredient or component part of other tangible personal property" includes only those items that become physically incorporated into the property and not those which are merely consumed or used in the production of the property sold.

(b) Lump-Sum Sales of Tangible Personal Property. ~~Application of Tax to Charges Made by Advertising Agencies.~~

(1) An agency that has a contract or agreement to sell tangible personal property for a lump-sum amount is a retailer of the tangible personal property and tax applies to the lump-sum selling price, except for artwork. An advertising agency, commercial artist or designer making a lump-sum sale of tangible personal property to a client may issue a resale certificate to a supplier. ~~Agency Acting as Seller—Sale of Tangible Personal Property. (See subsection (a)(2) for determination of status.) With respect to billings issued by advertising agencies to clients, some charges may represent the sale price of tangible personal property sold to the client by the agency and compensation for expenses incurred in, and service costs related to, the production of the property. Tax applies to the total amount of the retail sale of the property. Tax applies whether the property was prepared by employees of the agency or acquired from an outside source. Whether the items of property are used for reproduction or display purposes is immaterial.~~

~~On sales of artwork for which an advertising agency, commercial artist or designer makes a lump-sum charge that includes both the nontaxable services defined in subdivision (d)(1) and finished art, it will be rebuttably presumed that 75% of the lump-sum charge is for the nontaxable services. Tax applies to all charges made for such property, including charges for copy written solely for use as a part of such property. Tax applies to charges for services rendered that represent services that are a part of a sale of the property, or a labor or service cost in the production of the property. Charges for such items as supervision, consultation, research, postage, express, telephone and telegraph messages, and travel expense, if involved in the rendering of such services, are likewise taxable. No deduction may be taken on account of the payment of model fees or talent fees, or for the cost of typography, or for the cost of other services involved in the producing of such items, even though such costs are itemized in the billing rendered to the client.~~

~~If an agency supplies tangible personal property such as finished artwork to a client and the entire payment for such property is included in some other form of compensation such as a fee, commissions or a combination thereof, tax applies to the fair retail selling price of such property.~~

~~“Fair retail selling price” is an amount sufficient to cover (i) the net labor costs of employees of the agency plus an allowance for overhead and profit of not less than 100 percent of such labor cost, and (ii) the cost of purchased items incorporated into the tangible personal property as to which the agency is a seller. If an agency has furnished a firm quoted price based on estimated labor costs plus overhead and profit of not less than 100 percent of the labor cost and bills in accordance with such a quoted price, the agency will be deemed to have charged a fair retail selling price.~~

~~(2) Taxable Selling Price. Agency Acting as Agent—Reimbursement for Property Acquired as Agent. If advertising agencies, commercial artists or designers combine charges for nontaxable services, such as media placement, with the charges for tangible personal property of which the agencies, artists or designers are the retailers, they shall report a “taxable selling price” for the tangible personal property that includes the total of: 1. direct labor, 2. the cost of purchased items that become an ingredient or component part of the tangible personal property and the cost of any intermediate production or printing aids, and 3. a reasonable markup. An advertising agency, commercial artist or designer must keep sufficient records to document the basis for the reported taxable selling price. (See subsection (a)(2) for determination of status.) Some charges may represent reimbursement for tangible personal property acquired by the agency as agent for its client and compensation for the performance of agency services related thereto.~~

~~When an advertising agency establishes that it has acquired tangible personal property as agent for its client, tax does not apply to the charge made by the agency to its client for reimbursement including tax reimbursement charged by a supplier or to the charge made for the performance of the agency's services directly related to such acquisitions of personal property.~~

~~(3) Specific Nontaxable Charges. Services and Expenses—When Nontaxable. The following and similar fees, commission, and services are nontaxable if separately stated. If not separately stated, these charges are not considered direct labor when calculating a taxable selling price as defined in subdivision (b). Some charges may represent the price for the performance of services rendered that do not represent services that are a part of a sale of tangible personal property, or a labor or service cost in the~~

~~production of such property. Tax does not apply to charges for services rendered that do not represent services that are a part of a sale of tangible personal property, or a labor or service cost in the production of tangible personal property. Charges for such items as supervision, consultation, research, postage, express, telephone and telegraph messages, and travel expense, if involved in the rendering of such services, are likewise nontaxable.~~

(A) Agent fees added to purchases of tangible personal property by agencies established as agents for their clients as compensation for their performances of services related to such purchases.

(B) Media commissions derived by agencies for placement of advertising whether paid by the medium, by another agency, or by the client. The service of placing of advertising is not a service that is a part of a sale of tangible personal property.

(C) Commissions paid to agencies by suppliers. Examples of such commissions are those paid to an agency by a premium manufacturer (or distributor) or a direct-by-mail supplier.

(D) Consultation and concept development fees related to client discussion, development of ideas and other services. Tangible personal property produced as a result of these services is incidental to the service and nontaxable.

(E) Research or account planning that entail consumer research and the application of that research to the client's business or industry.

(F) Quality control supervision that entails the proofing and review of printing and other products provided by outside vendors.

(G) Separately stated charges for the formulation and writing of copy.

(4) Taxable Charges for Agencies Acting as Retailers. Specific Applications. All other commissions, fees or services exclusively related to the production or fabrication of tangible personal property are taxable and are considered part of direct labor. Such charges include retouching of photographs or other artwork for reproduction, provided the retouching is intended to improve the quality of the reproduction. Retouching for the purpose of repairing or restoring a photograph to its original condition is not taxable.

~~-(A) Preliminary Art. "Preliminary art" means roughs, visualizations, layouts and comprehensives, title to which does not pass to the client but which is prepared by an advertising agency, commercial artist or designer solely for the purpose of demonstrating an idea or message for acceptance by the client before a contract is entered into or before approval is given for preparation of finished art to be furnished by the agency, commercial artist or designer to its client. Tax does not apply to separate charges for preliminary art except where the preliminary art becomes physically incorporated into the finished art, as, for example, when the finished art is made by inking directly over a pencil sketch or drawing, or the approved layout is used as camera copy for reproduction. If the preliminary art is prepared on data processing equipment, the advertising agency, commercial artist, or designer shall produce a hard copy~~

~~of each of the roughs, visualizations, layouts or comprehensives presented for client approval and retain such copies in accordance with subdivision (d) of Regulation 1698.~~

~~The charge for preliminary art must be billed separately to the client, either on a separate billing or separately charged for on the billing for the finished art. It must be clearly identified on the billing as preliminary art. Proof of ordering or producing the preliminary art, prior to the date of the contract or approval for finished art, shall be evidenced by purchase orders of the buyer, or by work orders or other records of the agency, commercial artist or designer. No other proof shall be required.~~

~~—(B) Finished Art. “Finished art” means the final art used for actual reproduction by photo-mechanical or other processes; or for display purposes including charts, graphs, and illustrative materials not reproduced. Tax applies to the total charges made by advertising agencies, commercial artists or designers to their clients for finished art produced by them.~~

~~—(C) Consultation and Research. Tax applies to charges for consultation and research if the consultation or research relates solely to tangible personal property as to which the agency is acting as a seller. Tax does not apply to such charges in other circumstances, including those in which the agency is acting as agent, or where research charges relate to advertising testing even though the agency may have been the seller of tangible personal property used in conveying the advertising message.~~

~~—(D) Supervision. Tax applies to charges for supervision if the supervision relates directly and solely to tangible personal property as to which the agency is acting as a seller, for example, supervision of an art department engaged in the production of tangible personal property sold to a client. Tax does not apply when the agency is acting as agent or when charges for supervision do not relate solely to tangible personal property.~~

~~—(E) Copy Writing. Tax applies to charges for writing copy written solely for use as a part of tangible personal property as to which the agency is acting as a seller. Tax does not apply to such charges in other circumstances or when the agency is acting as agent.~~

~~Tax does not apply where copy is furnished to media in manuscript form.~~

~~—(F) Typography Charges, Model Fees, Talent Fees. Tax applies to charges for typography, model fees (including reuse payments), and talent fees (including residual payments), made by agencies to their clients when such fees are part of the charge for tangible personal property sold by the agency. Tax does not apply to such charges or fees when the agency acts as agent.~~

~~—(G) Motion Picture Productions. Tax applies to motion picture productions, including those for television, in the manner set forth in Regulation 1529, “Motion Pictures”.~~

~~—(H) Purchase Agent Fees. Fees added to purchases of tangible personal property by agencies established as agents for their clients as compensation for their performances of services related to such purchases are not taxable.~~

~~—(I) Media Commissions. Commissions derived by agencies for placement of advertising are not taxable whether paid by the medium, by another agency, or by the client. The service of placing of advertising is not a service that is a part of a sale of tangible personal property.~~

~~—(J) Supplier Commissions. Commissions paid to agencies by suppliers are not taxable receipts of the agencies. Examples of such nontaxable commissions would be commissions paid to an agency by a premium manufacturer (or distributor) or a direct by mail supplier.~~

~~—(K) Fee Added to a Total Billing. The term “fee” as used herein means a general over all fee encompassing all agency services performed for the client. Such fees may be fixed or based on agency costs and are generally in lieu of commissions, fees added to purchases, and separate time charges added to jobs or agency projects or any combination thereof.~~

~~A fee added by an agency to a total billing encompassing items as to which the agency is a seller and items as to which tax does not apply is taxable in accordance with the ratio between the charges for the items as to which the agency is a seller and the charges for nontaxable items if the agency performed no duties as an agent of its client, within the standards set forth in (a)(2)(A), during the course of its performance under the contract with its client.~~

~~A fee added to a total billing encompassing taxable and nontaxable elements is not taxable if the agency has acted as agent for its client with respect to the acquisition of tangible personal property acquired for the client from outside sources, provided the taxable items are billed at their fair retail selling price.~~

~~If an agency which has acted as agent of its client fails to bill the items as to which it is a retailer at their fair retail selling price, as defined in (b)(1) above, the fee added to the billing is taxable in accordance with the ratio between the taxable and nontaxable charges.~~

~~—(L) Retouching. Retouching ordinarily constitutes a step in the process of preparing photographs or other artwork for reproduction, and is done to improve the quality of the reproductions. Tax applies to charges for photo retouching unless it can be clearly demonstrated that the retouching is done only for the purpose of repairing or restoring a photograph to its original condition.~~

(5) Charges and Transactions Governed by Other Regulations.

(A) Video or Film Productions. If video or film productions provided by an advertising agency to clients are qualified production services, the application of tax is determined by Regulation 1529, *Motion Pictures*.

(B) Audio Productions. An audio production provided by an advertising agency to a client falls under the provisions of Regulation 1527, *Sound Recording*. Tax will apply as defined by that regulation.

(C) Typography. Tax applies to charges for typography or composed type obtained from outside vendors as provided in Regulation 1541, *Printing and Related Arts*.

(c) ~~Commercial Artists and Designers. The tax applies to the entire amount charged by commercial artists or designers for items of tangible personal property such as drawings, paintings, designs or sketches transferred to the client, whether or not the property is suitable for display or is useful for actual reproduction by photo-mechanical or other processes.~~

General. Commercial artists and designers provide services, electronic artwork, and tangible personal property to their clients. Services include, but are not limited to, the creation and development of ideas, concepts, looks, or messages. Electronic artwork can be transferred either through remote telecommunications, such as a modem, or by electronic media such as diskettes or compact disks. Tangible personal property includes both electronic media on which electronic artwork is transferred to the client and hard copies of the electronic artwork, or manually created art. "Finished art" means the final art used for actual reproduction by photomechanical or other processes, or used for display. It includes, but is not limited to, electronic art, illustrations (e.g. drawings, diagrams, halftones, or color images), photographs, paintings, and handlettering. Blueprints, diagrams, and instructions for signage furnished to a client as the result of environmental graphic design services are not "finished art." Tax does not apply to separate charges for preliminary art as defined in (b)(4)(A).

An advertising agency that provides creative or development services for the sole purpose of furnishing finished art to their clients is subject to tax as provided in subdivision (d).

(d) Application of Tax to Commercial Artists, Designers and Advertising Agencies. Items Purchased by Agency or by Artist or Designer. ~~An advertising agency, artist, or designer is the consumer of tangible personal property used in the operation of its business. Such property may include stationery, ink, paint, tools, drawing tables, T-squares, pens, pencils, and other office supplies. Tax applies to the sale of such property to the agency, artist, or designer.~~

~~The agency, artist, or designer is the seller of, and may purchase for resale, any tangible personal property that it resells before use, or that becomes physically an ingredient or component part of tangible personal property sold by it prior to use. Such property may include illustration board, paint, ink, rubber cement, flap paper, wrapping paper.~~

~~An advertising agency, artist, or designer is the consumer of property such as photographs and art which it uses in the preparation of tangible personal property as to which it is acting as a seller unless, prior to any use having been made of the property, the property is sold or becomes an ingredient or component part of other tangible personal property sold. The agency, artist, or designer may purchase for resale photographs and art which, prior to any use, are sold or become physically an ingredient or component part of other tangible personal property that is sold by the agency, artist, or designer.~~

~~The term "ingredient or component part of other tangible personal property" includes only those items that become physically incorporated into the property sold and not those which are merely consumed or used in the production of the property sold. A photograph, for example, does not become an ingredient or component part of property sold merely because the image of the photograph is reproduced as part of the property sold. A photograph or art is regarded as having been used when a reproduction is made from the photograph or art.~~

(1) Services. Services performed to convey ideas, concepts, looks or messages to a client may result in a transfer, enhancement or revision of either electronic artwork, hard copies of electronic artwork, or copies of manually prepared artwork. If charges for such services are separately stated as “design charges,” “preliminary art,” “concept development,” or any other designation that clearly indicates that the charges are for such services and not for finished art, they are nontaxable unless the contract of sale provides that the commercial artist or designer or advertising agency will pass to the client title or the right to permanent possession of the electronic media or hard copy.

A commercial artist or designer or advertising agency who provides nontaxable services is the consumer of tangible personal property used in the performance of such services and tax applies to the sale of property to the commercial artist or designer or advertising agency.

(2) Electronic Artwork and Finished Art. A transfer of electronic artwork from a commercial artist or designer or advertising agency to a customer or to a third party on behalf of the customer is not taxable if the file containing the electronic artwork is transferred through remote telecommunications, or if the file is loaded on the customer’s computer by the commercial artist or designer or advertising agency, and the customer does not obtain title to or possession of any tangible personal property, such as electronic media. The graphic artist or advertising agency should document his or her transfer and loading of electronic artwork on the client’s computer by a statement on the invoice or contract with the following language: “This electronic artwork was loaded onto my computer by (graphic artist’s or seller’s name). No electronic media, such as diskettes or compact disks, or hardcopies containing the artwork were transferred to me.” This statement should be signed or initialed by the client. When such a statement is timely completed, it will be rebuttably presumed that the transfer of electronic artwork is nontaxable. To be timely completed, the statement must be initialed or signed at the time the file is loaded or at the point the transfer is invoiced to the client. In lieu of the statement, the commercial artist or designer or advertising agency may provide other substantive evidence indicating that the artwork was transferred in an exempt manner.

The electronic or manual preparation of finished art for use in reproduction or display is not a service. Unless transferred or installed in the manner set forth in the preceding paragraph, tax applies to all charges for finished art, including to all charges for any rights, as provided in subdivision (d)(4), sold with the finished art, such as, without limitation, copyrights or distribution and production rights. If charges for finished art are combined with nontaxable services described in subdivision (d)(1), tax may be reported on a calculated selling price, as defined in subdivision (b2) provided the retail selling price also includes the value of rights as provided in subdivision (d)(4). In lieu of using a calculated selling price, commercial artists and designers or advertising agencies may use the method described in (b)(1), that is, it will be rebuttably presumed that 75% of a combined charge is for the nontaxable services.

If the commercial artist or designer or advertising agency uses any intermediate production or printing aids in the creation of the finished art, it will be presumed that title to the aids was passed to the client prior to use by the commercial artist or designer or advertising agency. The measure of tax for these aids will be computed in the same manner as provided by Regulation 1541 for special printing aids. Intermediate production or printing aids include, but are not limited to, artwork, illustrations, photography, photo engravings, and other similar materials.

(3) Signage. Tax does not apply to the services to create single copies of blueprints, diagrams, and instructions for signage provided as a result of environmental graphic design. Reproduction charges for additional copies are taxable.

(4) Reproduction Rights. Charges for the transfer by a tangible medium of a photograph or of finished art for purposes of reproduction are taxable even though there is no transfer of title to the person reproducing the photograph or work of art. Charges for the right to use the photograph or finished art which has been transferred by tangible medium in the production of tangible personal property are taxable. Charges for a license, copyright, or subpart of a copyright (such as a right to reproduce or to prepare derivative works) to exploit the photograph or finished art are taxable if they are sold along with the photograph or finished art transferred by tangible media or they are sold by a subsequent contract entered into within one year of the original transfer of the photograph or finished art.

Tax does not apply to a sale of an additional license, copyright, or the subpart of a copyright, or to the receipt of royalties received from the exploitation of a copyright, or subpart thereof, if such sale or receipt of royalties occurs more than one year from the date of the original transfer of the physical media containing the photograph or work of art so exploited. Such copyrights or royalties are not considered to have been sold along with finished art transferred by tangible media for the purposes of this subdivision and are deemed sales of nontaxable intangible property.

This limitation does not apply to sales or transfers for reproduction by a subsequent owner of the photograph or finished art, such as a stock photo or stock artwork house; however, where the stock photo or stock artwork house is merely acting as an agent for the original artist or photographer, the above limitation applies.

(5) Websites. The design, editing or hosting of an electronic website in which no tangible personal property is transferred to the customer is not subject to tax.

(e) Items Purchased by an Advertising Agency or by an Artist or Designer. An advertising agency, or commercial artist, or designer is the consumer of tangible personal property used in the operation of its business. Tax applies to the sale of such property to the agency, artist, or designer.

Note: Authority:Section 7051, Revenue and Taxation Code.

Reference: Sections 6006, 6010.3 and 6015, Revenue and Taxation Code.